Supreme Court, U.S.
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No. 95-1631

In the Supreme Court of the United States

OCTOBER TERM, 1995

FRANZ C. STANGL, PETITIONER

v.

ROBERT B. REICH, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether Section 502(a)(5) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1132(a)(5), authorizes a cause of action by the Secretary of Labor for equitable relief against a party in interest who has engaged, with an employee benefit plan, in transactions prohibited by Section 406(a) of ERISA, 29 U.S.C. 1106(a).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 26a-44a) is reported at 73 F.3d 1027. The decision and order of the district court (Pet. App. 1a-25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 10, 1996. The petition for a writ of certiorari was filed on April 9, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In June 1978, David R. Davidson, Jr. became a trustee of the Davidson Lumber Sales Inc. Employees Retirement Plan (the Plan), an employee pension

benefit plan. In addition, Davidson was a 50% limited partner in a business venture known as the S & D Limited Partnership (S & D). Petitioner held a 48% limited partnership interest and a two percent general partnership interest in S & D. Petitioner was also the sole general partner of another business venture, the Bowling Property Limited Partnership (Bowling), an entity formed to develop certain real estate in Sandy, Utah (the Sandy Property). On December 21, 1979, the Plan extended Bowling a $200,000 loan, evidenced by a promissory note and secured by a deed of trust on the Sandy Property. The note was renewed several times between 1979 and 1985, even though no payments had been made on it. Pet. App. 3a-4a, 27a-28a.

In 1985, petitioner entered into a series of agreements with Davidson, ostensibly for the purpose of reconciling their business relationship. Under the terms of one such agreement, Davidson personally assumed Bowling's obligations on the $200,000 loan and caused the Plan to reconvey to Bowling the deed of trust that had secured the loan. Pet. App. 4a, 28a.

2. In 1990, the Secretary of Labor filed suit against petitioner under Section 502(a)(5) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1132(a)(5), in the United States District Court for the District of Utah. Pet. App. 4a, 28a.[1] The Secretary alleged: (i) that, by causing the Plan to engage in the Bowling loan transactions, Davidson had breached his fiduciary duties to the Plan under ERISA, and petitioner knowingly participated in

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[1] The Secretary also brought claims against Davidson, which were resolved by means of a consent decree entered on August 16, 1993. See Pet. 4; Pet. App. 2a & n.1, 28a.

those breaches, *id.* at 5a, 28a; and (ii) that petitioner was a party in interest to the Plan, within the meaning of Section 3(14) of ERISA, 29 U.S.C. 1002(14), and the Bowling loan transactions were therefore unlawful under Section 406(a) of ERISA, 29 U.S.C. 1106(a). Pet. App. 5a-8a, 28a. The Secretary sought equitable relief, including an order of restitution requiring petitioner to return to the Plan the unjust enrichment he received through the prohibited loan transactions, a constructive trust on petitioner's interest in the Sandy Property, and an order permanently enjoining petitioner from serving as an ERISA fiduciary. *Id.* at 4a-5a, 28a-29a & n.1.[2]

On cross-motions for summary judgment, the district court entered judgment for petitioner, having concluded that ERISA provides no cause of action against a nonfiduciary party in interest either for knowingly participating in a fiduciary breach or for engaging in a transaction prohibited by Section 406(a). Pet. App. 1a-25a. As to the former, the court relied heavily on a discussion in this Court's decision in *Mertens* v. *Hewitt Assocs.*, 508 U.S. 248 (1993), which suggested (but expressly did not decide) that ERISA provides no cause of action for knowing participation in a fiduciary breach. Pet. App. 13a. See 508 U.S. at 253-255. The court found *Mertens* "less clear" with regard to the liability of nonfiduciary parties in interest for engaging in prohibited transactions, Pet. App. 17a, but concluded (primarily based on its impression of the legislative history) that Congress intended to impose liability for violations of

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[2] The Secretary also sought compensatory damages, but he withdrew that request following this Court's decision in *Mertens* v. *Hewitt Assocs.*, 508 U.S. 248 (1993).

the prohibited transaction rules only on plan fiduciaries, *id.* at 18a-23a.

3. The court of appeals reversed the district court's judgment with regard to the prohibited transactions claim. Pet. App. 26a-44a.[3] Looking first to the statutory text, it concluded that the Secretary's suit was authorized under Section 502(a)(5) as an action "'for appropriate equitable relief' to redress a violation of section 406 and to enforce that section's prohibition of transactions with parties in interest." Pet. App. 31a-32a. Like the other courts of appeals that have ruled on the issue, it found that "the fact that section 406(a) expressly imposes duties on fiduciaries rather than on parties in interest does not limit the Secretary's authority to file equitable actions against those parties in interest who have engaged in prohibited transactions." Pet. App. 34a-35a; see also *id.* at 33a-34a (citing *Nieto* v. *Ecker*, 845 F.2d 868, 873-874 (9th Cir. 1988); *Landwehr* v. *DuPree*, 72 F.3d 726, 734 (9th Cir. 1995); *Concha* v. *London*, 62 F.3d 1493, 1503-1504 (9th Cir. 1995), cert. dismissed, 116 S. Ct. 1710 (1996); *Reich* v. *Compton*, 57 F.3d 270, 285-287 (3d Cir. 1995); *Reich* v. *Rowe*, 20 F.3d 25, 31 (1st Cir. 1994)).

The court of appeals observed that, in *Mertens*, this Court expressly contrasted the absence of any provision prohibiting a nonfiduciary from knowingly participating in a fiduciary's breach, with Section 406(a)'s explicit prohibition on parties in interest engaging in certain transactions. Pet. App. 37a (citing *Mertens*, 508 U.S. at 253-254). It reasoned therefrom that, whatever doubt this Court's

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[3] The Secretary did not appeal the district court's judgment with regard to the knowing participation claim.

statements might cast on actions against nonfiduciaries for knowing participation, *Mertens* "should not be read to preclude claims concerning prohibited transactions under section 406." Pet. App. 38a. It noted that the courts of appeals that have decided the issue have uniformly concluded that *Mertens* does not preclude "equitable actions seeking restitution from parties in interest." *Id.* at 39a, citing *Concha*, 62 F.3d at 1503-1504; *Compton*, 57 F.3d at 287; *Rowe*, 20 F.3d at 33.

Unlike the district court, the court of appeals did not view the legislative history as evincing any intent to preclude equitable actions against parties in interest. Pet. App. 41a-43a. Congress's rejection of a provision that would have explicitly imposed civil liability on parties in interest did not, in the court's view, demonstrate a congressional desire to immunize parties in interest from liability for violating the prohibited transaction rules, given Congress's express authorization in Section 502 of suits for "appropriate equitable relief" for any act or practice violative of Title I of ERISA. Pet. App. 42a.

Finally, the court of appeals found probative certain provisions in the Internal Revenue Code that authorize the Secretary of the Treasury to assess excise taxes on parties in interest who participate in prohibited transactions. Pet. App. 43a. In particular, the court noted (*ibid.*) the requirement in 26 U.S.C. 4975(h) that, before assessing such a tax on a party in interest who has engaged in a prohibited transaction, the Secretary of the Treasury must provide the Secretary of Labor with "a reasonable opportunity to obtain a correction." In the court's view, the Secretary of Labor's presumed ability to "correct[]" a prohibited transaction bolsters the Secretary's

authority under Section 502(a)(5) to seek orders of restitution against parties in interest. Pet. App. 43a.

ARGUMENT

Petitioner argues that the court of appeals erred in holding that Section 502(a)(5) of ERISA provides the Secretary of Labor with a cause of action for equitable relief against a nonfiduciary party in interest who has engaged in transactions prohibited by Section 406. Contrary to petitioner's argument, the court of appeals' holding is correct. It is, moreover, consistent with the conclusion of every other court of appeals that has ruled on the matter, and with this Court's discussion in *Mertens* v. *Hewitt Assocs.*, 508 U.S. 248 (1993). No further review is warranted.

1. The court of appeals' conclusion that the Secretary may sue a nonfiduciary party in interest for violating ERISA's prohibited transaction rules follows directly from the relevant statutory text. Section 502(a)(5) of ERISA states that the Secretary of Labor may bring a civil action "to enjoin any act or practice" that violates the requirements set forth in Title I of the Act, or "to obtain other appropriate equitable relief * * * to redress such violation." The term "redress" means "the setting right of what is wrong," *The Random House Dictionary of The English Language* 1617 (2d ed. 1987); *Webster's Third New International Dictionary* 1904 (1986), and the equitable relief "appropriate" to obtain such redress "includes restitution of ill-gotten plan assets or profits," *Mertens*, 508 U.S. at 260.

Section 406(a) of ERISA, 29 U.S.C. 1106(a), is a provision within Title I of the Act. It prohibits a plan fiduciary from causing a plan to engage in certain enumerated transactions with (or benefitting) related

parties, referred to under ERISA as "part[ies] in interest."[4] Among other things, it prohibits loans and other extensions of credit between a plan and a party in interest, as well as the transfer of plan assets to, or use of such assets by or for the benefit of, a party in interest.[5] In making such transactions illegal per se, "Congress' goal was to bar categorically a transaction that was likely to injure the pension plan." *Commissioner* v. *Keystone Consol. Indus., Inc.*, 508 U.S. 152, 160 (1993).[6]

As the court of appeals observed, "the Secretary's action against [petitioner] is an action under section

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[4] "Part[ies] in interest" is defined broadly to include plan fiduciaries, plan employees, employers whose employees are covered by a plan, service providers, employee organizations whose employees are covered by a plan, owners of at least 50% or more of stock in those employers, employee organizations, and certain relatives of parties in interest, as well as officers, shareholders and directors of entities that are themselves parties in interest, and owners of ten percent or more of such entities. 29 U.S.C. 1002(14).

[5] Section 406(a) provides in relevant part:

> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect —
>
> > (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
> >
> > (B) lending of money or other extension of credit between the plan and a party in interest; [or]
> >
> > * * * * *
> >
> > (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan[.]

[6] Section 408 of ERISA, 29 U.S.C. 1108, exempts certain transactions from ERISA's prohibited transaction provisions, but those exemptions are not relevant here.

502 'for appropriate equitable relief' to redress a violation of section 406 and to enforce that section's prohibition of transactions with parties in interest." Pet. App. 32a. Although Section 406(a) imposes the duty to avoid prohibited transactions on the fiduciary, rather than the party in interest, since the "act or practice" of engaging in a prohibited transaction by definition involves both the fiduciary and the party in interest (who may or may not be a fiduciary), Section 502(a)(5) encompasses actions for equitable relief against nonfiduciary parties in interest.[7]

That conclusion is supported by the parallel tax treatment of prohibited transactions in Title II of ERISA. The Internal Revenue Code requires that, before assessing an excise tax on a party in interest who has engaged in a prohibited transaction, the Secretary of the Treasury must provide the Secretary of Labor with an opportunity to obtain a "correction." 26 U.S.C. 4975(h). The term "correction" is defined as "undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards." 26 U.S.C. 4975(f)(5). The clear implication of those provisions is that the Secretary of Labor has the authority to seek equitable relief against a party in interest when such relief is necessary to "correct[]" the prohibited

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[7] Even if the statutory language were amenable to differing interpretations, considering that "[c]ourts may find it difficult or impossible to undo such illegal transactions unless they have jurisdiction over all parties who allegedly participated in them," *Nieto*, 845 F.2d at 874, it is hard to conceive of "any ERISA-related purpose that denial of a remedy would serve." *Varity Corp.* v. *Howe*, 116 S. Ct. 1065, 1079 (1996).

transaction. Petitioner's suggestion (Pet. 14-15) that ERISA establishes airtight jurisdictional divisions between the enforcement authority of the Secretary of Labor (over fiduciary acts) and that of the Secretary of the Treasury (over parties in interest) ignores the overlapping and complementary nature of their roles in this context.[8]

2. Contrary to petitioner's contention (Pet. 11-16), the legislative history of ERISA does not demonstrate a congressional intent to foreclose equitable actions against parties in interest. To be sure, Sections 409(a) and 502(a)(2) of ERISA, 29 U.S.C. 1109(a) and 1132(a)(2), which make fiduciaries susceptible to compensatory damages *and* equitable remedies, do not provide for party-in-interest liability for losses caused by a prohibited transaction, as did the pertinent Senate bill. H.R. 2, 93d Cong., 2d Sess. 533 (1974), *reprinted in* Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare, 94th Cong., 2d Sess., *Legislative History of the Employee Retirement Income Security Act of 1974*, at 3780 (Comm. Print 1976). But while that may indicate that "the fiduciary is the main focus of the prohibited transaction rules" under Title I of ERISA, H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 306 (1974), it does not suggest that redress, limited to "appropriate equitable relief," may not be obtained under Section 502(a)(5) against nonfiduciary parties in interest. As this Court explained in *Varity Corp.* v. *Howe*, 116 S.

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[8] See *McDougall* v. *Donovan*, 539 F. Supp. 596, 599 (N.D. Ill. 1982) ("Congress envisioned overlapping authority between the Department of Labor and the Internal Revenue Service in the administration and enforcement of pension plan standards under ERISA.").

Ct. 1065, 1078 (1996), Section 502(a)(5) is a "'catchall' provision[] [that] act[s] as a safety net, offering appropriate equitable relief for injuries caused by violations that § 502 does not elsewhere adequately remedy." Cf. 116 S. Ct. at 1077-1078 (holding that Section 502(a)(3) authorizes an individual cause of action for breaches of fiduciary duties that injure individual participants and beneficiaries, notwithstanding the absence of any provision for an individual cause of action under Sections 502(a)(2) and 409(a).[9]

3. Given the textual and structural support for the court of appeals' holding, there is no basis for petitioner's assertion that the court impermissibly "*inferred*" a cause of action against nonfiduciary parties in interest. Pet. 6; see also Pet. App. 8-10 (citing *Mertens*, 508 U.S. at 254-255 & n.5, and *Massachusetts Mut. Life Ins. Co.* v. *Russell*, 473 U.S. 134, 146-147 (1985)). Indeed, contrary to petitioner's suggestion, this Court's discussion in *Mertens* respecting inferred causes of action supports the decision below. While the Court expressed doubt that ERISA provides a cause of action against a nonfiduciary for participating in a fiduciary breach (in the absence of any express duty on the part of a nonfiduciary to refrain from such participation), it contrasted the Act's silence on that issue with provisions of the Act, such as Section 406(a), that "can be read as imposing obligations upon nonfiduciaries." See 508 U.S. at 253-254 & n.4. Indeed, the Court specifically observed that "[p]rofessional service providers," like the respondents in *Mertens*,

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[9] Because of the parallel language in the two provisions, Section 502(a)(3) is properly construed in the same manner as Section 502(a)(5) in this regard. See *Mertens*, 508 U.S. at 260.

"must disgorge assets and profits obtained through participation as parties-in-interest in transactions prohibited by § 406." *Id.* at 262; see *Lockheed Corp.* v. *Spink*, No. 95-809 (June 10, 1996), slip op. 6 n.3.

4. Finally, as the court of appeals observed (Pet. App. 33a-34a, 39a), its resolution of this case was consistent with the decision of every court of appeals that has considered the issue. See *Compton*, 57 F.3d at 285-287 (ERISA authorizes action for equitable relief against nonfiduciary parties in interest who engage in prohibited transactions); accord *Rowe*, 20 F.3d at 33; *Nieto*, 845 F.2d at 873-874.[10]

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[10] The Ninth Circuit recently rejected the suggestion that *Nieto* has been overruled by *Mertens*:

> It is one thing to suggest, as does *Mertens*, that a nonfiduciary may not be held liable for participating in another's breach of fiduciary duty. It is quite another to say that a nonfiduciary may not be held liable for his own wrongful conduct—specifically, for engaging in a prohibited transaction * * * . Indeed, *Mertens* expressly states that nonfiduciary service providers "must disgorge assets and profits obtained through participation as parties-in-interest in transactions prohibited by [29 U.S.C. § 1106]." *Id.* [508] U.S. at [262].

Landwehr, 72 F.3d at 734; accord *Compton*, 57 F.3d at 285 ("*Mertens* itself seemed to imply that section 406(a) imposes duties on nonfiduciaries who participate in prohibited transactions.").

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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